NATIONAL ECONOMIC OUTLOOK

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Slower but Still Solid Economic Growth in the First Quarter; Lowest Unemployment Rate in 17 Years

- The U.S. economy expanded 2.3% at a seasonally adjusted annualized rate in first-quarter 2018. This was softer than the average 3% growth over the previous three quarters, but real GDP was up 2.9% from one year earlier in the first quarter, the biggest year-over-year gain since second-quarter 2015. The details were a bit weaker than the headline number. Inventories added 0.4 percentage point to growth after being a big drag in fourth-quarter 2018. Final sales of domestic product, which is GDP minus the change in inventories and measures domestic and foreign demand for goods and services produced in the United States, increased 1.9% at an annual rate in the first quarter.
- The United States added 164,000 jobs in April, with gains of 168,000 in the private sector and losses of 4,000 in the government sector. There was a combined upward revision to job growth in February and March of 30,000. The U.S. economy has added an average of 200,000 jobs per month so far in 2018, above last year's pace of 182,000. The unemployment rate fell 0.2 percentage point in April to 3.9%, down from 4.1% in the previous six months. This is the lowest unemployment rate since December 2000. However, the unemployment rate fell because the labor force (the number of people either working or looking for work) fell by 239,000 in April. The number of jobs in the household employment survey (different from the survey of employers) rose just 3,000 in April. Still, job growth in the household survey has averaged close to 300,000 so far in 2018. The broader U-6 unemployment rate (unemployed, underemployed, and too discouraged to look for a job) fell from 8.0% in March to 7.8%, its lowest since mid-2001. Average hourly earnings in April were up 2.6% from one year earlier, unchanged from the March pace.
- Productivity in the nonfarm business sector rose 0.7% at an annual rate in the first quarter. This was an acceleration from the 0.3% increase in the fourth quarter of last year but below the 1.3% pace for all of 2017. After solid gains in the middle of last year, productivity growth slowed in late 2017 and early 2018. Productivity growth has been disappointing throughout the current economic expansion. Absent an acceleration in productivity growth, we believe economic growth in the United States is likely to remain well below its long-run average.

Table 1
Baseline U.S. Economic Outlook, Summary*

	1Q18F	2Q18F	3Q18F	4Q18F	1Q19F	2Q19F	3Q19F	4Q19F	2017	2018F	2019F	2020F
Output & Prices												
Real GDP (Chained 2009 Billions $)	17386	17541	17676	17819	17951	18068	18170	18263	17096	17606	18113	18472
Percent Change Annualized	**2.3**	**3.6**	**3.1**	**3.3**	**3.0**	**2.6**	**2.3**	**2.1**	**2.3**	**3.0**	**2.9**	**2.0**
CPI (1982-84 = 100)	249.4	251.4	252.5	253.8	255.2	256.6	257.9	259.3	245.1	251.8	257.3	262.9
Percent Change Annualized	**3.5**	**3.1**	**1.9**	**2.0**	**2.2**	**2.2**	**2.2**	**2.2**	**2.1**	**2.7**	**2.2**	**2.2**
Labor Markets												
Payroll Jobs (Millions)	148.1	148.6	149.2	149.6	150.0	150.3	150.6	150.9	146.6	148.9	150.5	151.4
Percent Change Annualized	**1.7**	**1.6**	**1.4**	**1.3**	**1.1**	**0.8**	**0.8**	**0.7**	**1.6**	**1.5**	**1.1**	**0.6**
Unemployment Rate (Percent)	4.1	3.9	3.8	3.6	3.5	3.5	3.5	3.5	4.4	3.9	3.5	3.6
Interest Rates (Percent)												
Federal Funds	1.45	1.64	1.65	1.93	2.17	2.42	2.52	2.52	1.00	1.67	2.41	2.52
Treasury Note, 10-year	2.76	2.91	2.99	3.13	3.26	3.36	3.41	3.37	2.33	2.95	3.35	3.26

F = forecast * Please see Table 2, page 2, for more forecast series.

Source: PNC, Federal Reserve, Bureau of Labor Statistics, Bureau of Economic Analysis

Table 2
Baseline U.S. Economic Outlook

	1Q18F	2Q18F	3Q18F	4Q18F	1Q19F	2Q19F	3Q19F	4Q19F	2017	2018F	2019F	2020F
Output												
Nominal GDP (Billions $)	19965	20298	20547	20809	21066	21311	21540	21760	19391	20405	21419	22294
Percent Change Annualized	**4.3**	**6.8**	**5.0**	**5.2**	**5.0**	**4.7**	**4.4**	**4.2**	**4.1**	**5.2**	**5.0**	**4.1**
Real GDP (Chained 2009 Billions $)	17386	17541	17676	17819	17951	18068	18170	18263	17096	17606	18113	18472
Percent Change Annualized	**2.3**	**3.6**	**3.1**	**3.3**	**3.0**	**2.6**	**2.3**	**2.1**	**2.3**	**3.0**	**2.9**	**2.0**
Pers. Consumption Expenditures	12067	12147	12224	12299	12368	12428	12488	12545	11891	12184	12457	12691
Percent Change Annualized	**1.1**	**2.7**	**2.6**	**2.5**	**2.3**	**2.0**	**1.9**	**1.9**	**2.8**	**2.5**	**2.2**	**1.9**
Nonresidential Fixed Investment	2401	2441	2486	2530	2568	2599	2627	2651	2314	2465	2611	2695
Percent Change Annualized	**6.1**	**6.9**	**7.6**	**7.3**	**6.2**	**4.9**	**4.3**	**3.7**	**4.7**	**6.5**	**6.0**	**3.2**
Residential Investment	605	609	612	619	626	632	636	640	598	611	633	649
Percent Change Annualized	**0.0**	**2.4**	**2.4**	**4.2**	**4.6**	**4.0**	**2.8**	**2.3**	**1.8**	**2.2**	**3.6**	**2.4**
Change in Private Inventories	33	57	58	56	57	63	57	51	15	51	57	41
Net Exports	-646	-656	-671	-685	-698	-705	-710	-712	-622	-665	-706	-715
Government Expenditures	2930	2948	2970	3004	3034	3056	3077	3092	2903	2963	3065	3116
Percent Change Annualized	**1.2**	**2.4**	**3.1**	**4.6**	**4.0**	**3.0**	**2.7**	**2.0**	**0.1**	**2.1**	**3.4**	**1.7**
Industrial Prod. Index (2012 = 100)	106.4	107.3	108.1	108.7	109.2	109.5	109.9	110.2	103.7	107.6	109.7	110.9
Percent Change Annualized	**4.5**	**3.3**	**2.9**	**2.2**	**1.8**	**1.3**	**1.2**	**1.1**	**1.6**	**3.8**	**1.9**	**1.2**
Capacity Utilization (Percent)	77.6	78.1	78.3	78.5	78.8	78.8	78.8	78.8	76.1	78.1	78.8	78.7
Prices												
CPI (1982-84 = 100)	249.4	251.4	252.5	253.8	255.2	256.6	257.9	259.3	245.1	251.8	257.3	262.9
Percent Change Annualized	**3.5**	**3.1**	**1.9**	**2.0**	**2.2**	**2.2**	**2.2**	**2.2**	**2.1**	**2.7**	**2.2**	**2.2**
Core CPI Index (1982-84 = 100)	255.7	257.3	258.8	260.2	261.6	263.0	264.4	265.9	252.2	258.0	263.7	269.5
Percent Change Annualized	**3.0**	**2.5**	**2.3**	**2.2**	**2.2**	**2.2**	**2.2**	**2.2**	**1.8**	**2.3**	**2.2**	**2.2**
PCE Price Index (2009 = 100)	114.2	115.0	115.5	116.0	116.5	117.0	117.5	118.1	112.7	115.2	117.3	119.4
Percent Change Annualized	**2.7**	**2.8**	**1.6**	**1.8**	**1.8**	**1.8**	**1.8**	**1.8**	**1.7**	**2.2**	**1.8**	**1.8**
Core PCE Price Index (2009 = 100)	114.5	115.1	115.7	116.2	116.8	117.4	118.0	118.5	113.1	115.4	117.7	120.0
Percent Change Annualized	**2.5**	**2.2**	**2.1**	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	**1.5**	**2.0**	**2.0**	**2.0**
GDP Price Index (2009 = 100)	114.8	115.7	116.3	116.8	117.4	118.0	118.7	119.3	113.4	115.9	118.4	120.8
Percent Change Annualized	**2.0**	**3.2**	**1.9**	**1.9**	**2.0**	**2.1**	**2.1**	**2.1**	**1.8**	**2.2**	**2.1**	**2.1**
Crude Oil, WTI ($/Barrel)	62.9	72.2	71.5	71.2	72.0	72.9	73.8	74.7	50.8	69.4	73.4	75.6
Labor Markets												
Payroll Jobs (Millions)	148.1	148.6	149.2	149.6	150.0	150.3	150.6	150.9	146.6	148.9	150.5	151.4
Percent Change Annualized	**1.7**	**1.6**	**1.4**	**1.3**	**1.1**	**0.8**	**0.8**	**0.7**	**1.6**	**1.5**	**1.1**	**0.6**
Unemployment Rate (Percent)	4.1	3.9	3.8	3.6	3.5	3.5	3.5	3.5	4.4	3.9	3.5	3.6
Average Weekly Hours, Prod. Works.	33.7	33.7	33.8	33.8	33.8	33.8	33.8	33.8	33.7	33.8	33.8	33.8
Personal Income												
Average Hourly Earnings ($)	22.40	22.56	22.72	22.90	23.09	23.28	23.46	23.65	22.05	22.65	23.37	24.12
Percent Change Annualized	**2.8**	**2.9**	**3.0**	**3.2**	**3.3**	**3.3**	**3.2**	**3.2**	**2.3**	**2.7**	**3.2**	**3.2**
Real Disp. Income (2009 Billions $)	12930	12969	13038	13099	13165	13229	13289	13349	12763	13009	13258	13499
Percent Change Annualized	**3.4**	**1.2**	**2.1**	**1.9**	**2.0**	**2.0**	**1.8**	**1.8**	**1.2**	**1.9**	**1.9**	**1.8**
Housing												
Housing Starts (Ths., Ann. Rate)	1318	1284	1305	1331	1354	1370	1378	1385	1208	1309	1372	1395
Ext. Home Sales (Ths., Ann Rate)	5507	5538	5625	5716	5775	5811	5838	5862	5536	5597	5822	5908
New SF Home Sales (Ths., Ann Rate)	668	654	667	682	694	701	705	708	617	668	702	710
Case/Shiller HPI (Jan. 2000 = 100)	198.9	201.0	202.6	203.7	204.7	205.5	206.4	207.2	191.7	201.5	206.0	209.9
Percent Change Year Ago	**5.8**	**5.8**	**5.2**	**3.7**	**2.9**	**2.3**	**1.9**	**1.8**	**5.9**	**5.1**	**2.2**	**1.9**
Consumer												
Household Economic Stress Index*	0.5	1.1	1.5	2.5	2.9	3.3	3.8	3.9	0.6	1.4	3.5	3.9
Auto Sales (Millions)	17.1	17.1	17.1	17.1	17.0	16.9	16.9	16.9	17.2	17.1	16.9	16.8
Consumer Credit (Billions $)	3864	3924	3982	4040	4099	4155	4214	4268	3758	3953	4184	4387
Percent Change Annualized	**2.4**	**6.4**	**6.0**	**6.0**	**5.9**	**5.6**	**5.8**	**5.2**	**5.7**	**5.2**	**5.9**	**4.8**
Interest Rates (Percent)												
Prime Rate	4.53	4.75	4.76	5.03	5.28	5.50	5.50	5.50	4.10	4.77	5.45	5.50
Federal Funds	1.45	1.64	1.65	1.93	2.17	2.42	2.52	2.52	1.00	1.67	2.41	2.52
3-Month Treasury Bill	1.58	1.85	1.95	2.13	2.29	2.43	2.51	2.46	0.95	1.88	2.42	2.42
10-Year Treasury Note	2.76	2.91	2.99	3.13	3.26	3.36	3.41	3.37	2.33	2.95	3.35	3.26
30-Year Fixed Mortgage	4.27	4.47	4.57	4.73	4.87	4.95	5.00	4.94	3.99	4.51	4.94	4.83
F=forecast												

**PNC Household Economic Stress Index (HESI) = Unemployment Rate + CPI % change year earlier – Home Price Index (HPI) % change year earlier*

Source: PNC, Federal Reserve, Bureau of Labor Statistics, Bureau of Economic Analysis

Trade Tensions Appear to Be Fading, but New Deals Likely Will Not Change the Outlook

After proposing steep tariffs on many imported goods, the Trump administration appears to be backing down. The administration is working toward an agreement under which China would increase imports from the United States, and negotiations continue with Canada and Mexico on changes to the North American Free Trade Agreement (NAFTA). Any changes are likely to be superficial and do little to boost U.S. economic growth. Over the long run, larger federal government budget deficits are likely to lead to larger trade deficits.

President Donald Trump campaigned in 2016 on a platform of raising trade barriers, arguing that other nations were taking advantage of the United States and harming the economy. This was a noticeable break from the bipartisan consensus since World War II, which generally viewed trade as a win-win outcome and favored reduced trade barriers. The administration's trade rhetoric heated up this year, with the president proposing a 25% tariff on imported steel and a 10% tariff on imported aluminum. This was ostensibly on national security grounds, but the president emphasized the supposed benefits for U.S. workers in promoting the tariffs. He also proposed a 25% tariff on many categories of goods imported from China, leading China to propose its own tariffs on politically sensitive goods from the United States, such as soybeans. The Trump administration recently barred U.S. firms from selling to Chinese tech company ZTE to punish it for violating sanctions on Iran and North Korea. The administration is also renegotiating NAFTA with Canada and Mexico.

The administration has backed off on some of these initial proposals, however. The steel and aluminum tariffs have not yet been implemented, in part because of opposition from industries that use imported steel and aluminum. The administration has temporarily exempted some major security partners and is negotiating permanent exemptions with them. The administration is also negotiating with China over ZTE and tariffs; there have been initial reports of a deal that would lead China to reduce its trade surplus with the United States by substantially increasing its purchases of U.S. goods, including agricultural products and aircraft. The NAFTA negotiations continue despite having run past a deadline set by Speaker of the U.S. House of Representatives Paul Ryan. The most likely outcome of these efforts will be cosmetic changes that would allow the Trump administration and U.S. trading partners to both claim victories but result in minimal changes to the current trade regime and have no discernable impact on the U.S. economic outlook. However, there may be downside risk to the U.S. outlook from back-and-forth trade restrictions that would likely raise costs for U.S. businesses and consumers and weigh on global growth and U.S. exports.

Over the long term, the Trump administration's efforts could do some damage to the U.S. economy. The administration appears focused on bilateral trade deficits and deals. This makes it more difficult for the United States to help set the "rules of the road" that will govern global trade over the long run. A example of this is the U.S. decision to drop out of negotiations over the Trans-Pacific Partnership. This approach also largely ignores less obvious but more arguably important issues, such as protection of intellectual property, which is a serious concern for innovative U.S. firms. In addition, federal budget policy may lead to larger U.S. trade deficits over the long run. It is an accounting identity that the trade deficit (technically the current account deficit) is equal to total saving minus domestically financed investment. Thus greater federal government borrowing, because of deficit-financed tax cuts and spending increases, may lead to reduced U.S. saving and larger U.S. trade deficits.

Although trade probably will be a drag, we anticipate real U.S. GDP growth may accelerate to above 3% on a year-over-year basis by late 2018. Business investment and consumer spending should both get boosts from the tax cuts, and the housing market will likely continue to improve despite higher mortgage rates. We believe a large increase in federal government spending will also be a near-term positive. We expect growth may then slow in 2019 as fiscal stimulus wears off. Job growth this year will likely maintain its 2018 pace of around 180,000 per month, and the unemployment rate will probably move lower, to around 3.5% by year end. Further, we believe the tighter job market will lead to faster wage growth, providing additional support to consumer spending and helping to offset the drag from higher energy prices.

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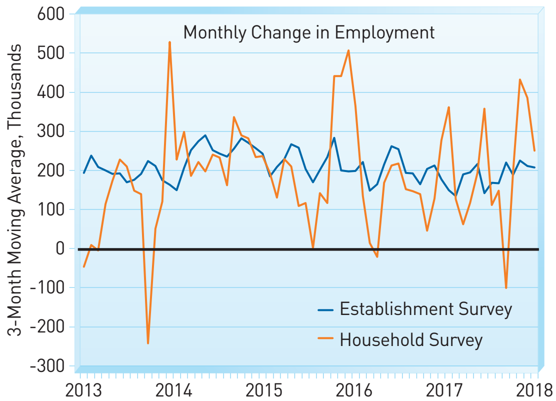
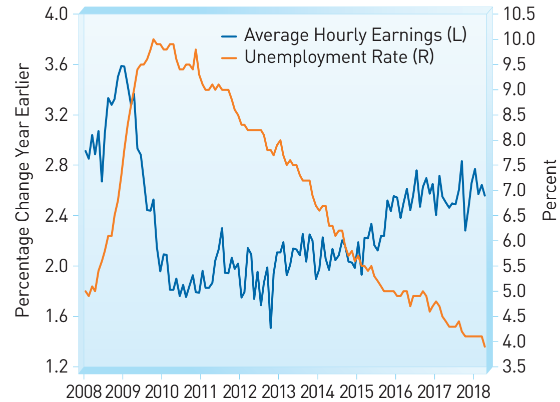
Chart 1
Monthly Job Growth So Far This Year
(As of 4/30/18)



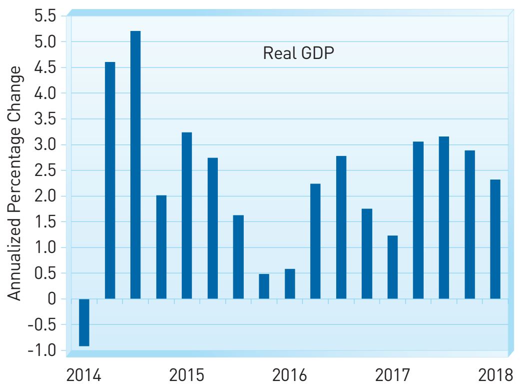
Source: Bureau of Economic Analysis

Chart 2
Unemployment Rate at Its Lowest Since 2000
(As of 4/30/18)



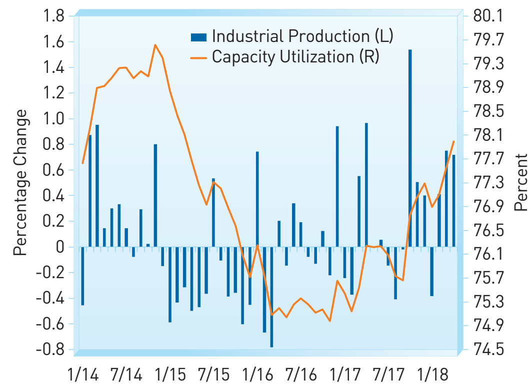
Source: Bureau of Labor Statistics

Chart 3
Growth Better than Recent First-Quarter Average
(As of 1Q2018)



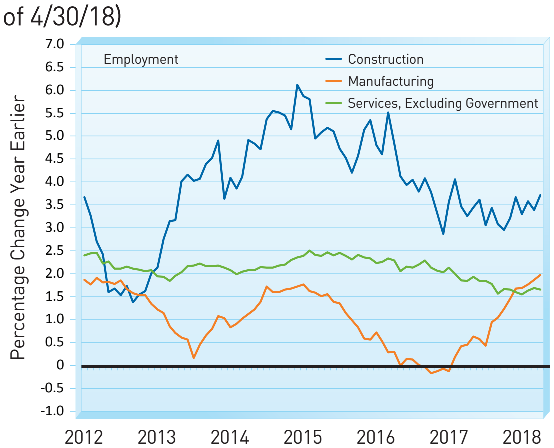
Source: Bureau of Economic Analysis

Chart 4
Industrial Sector Continues to Improve
(As of 4/30/18)



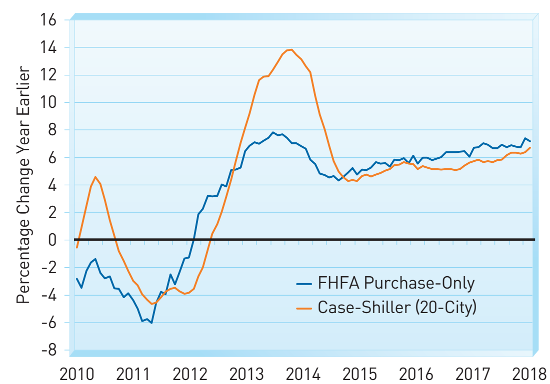
Source: Federal Reserve

Chart 5
Broad-Based Improvement in Labor Market
(As of 4/30/18)



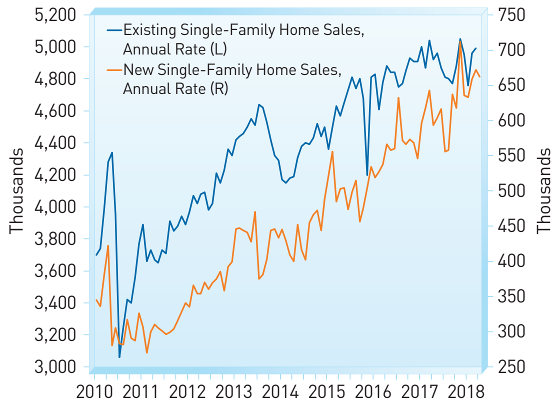
Source: Bureau of Labor Statistics

Chart 6
Higher Mortgage Rates Weigh on Near-Term House Price Growth
(As of 2/28/18)



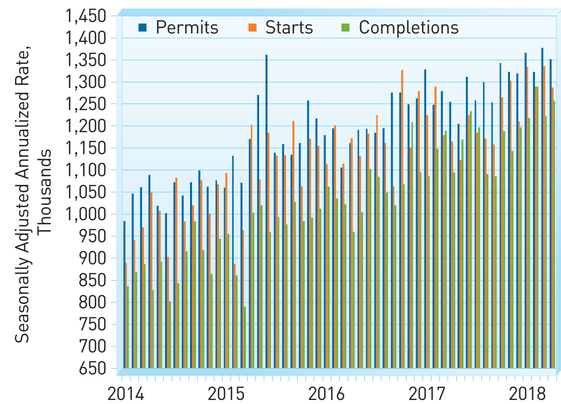
Source: Federal Housing Finance Agency, Standard & Poor's

Chart 7
Continued Improvement in Housing Demand
(As of 4/30/18)



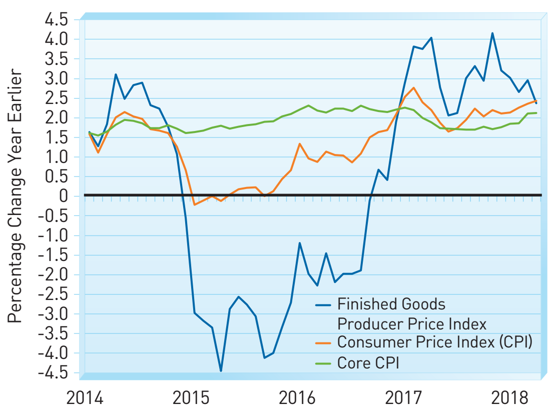
Source: National Association of Realtors®

Chart 8
Weakness in April Housing Starts on the Apartment Side
(As of 4/30/18)



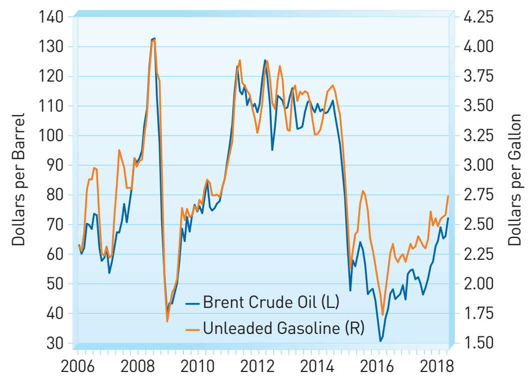
Source: Census Bureau

Chart 9
Fed Has Welcomed Gradual Acceleration in Inflation
(As of 4/30/18)



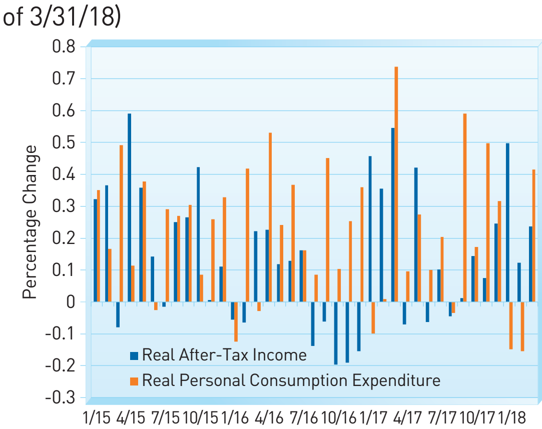
Source: Bureau of Labor Statistics

Chart 10
Jump in Oil Prices Helping to Push Overall Inflation Higher
(As of 4/30/18)



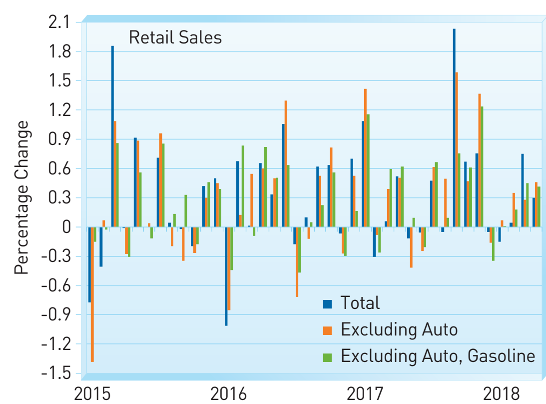
Source: Bloomberg L.P.

Chart 11
Better Consumer Spending Numbers in March
(As of 3/31/18)



Source: Bureau of Economic Analysis

Chart 12
Retail Sales Improved After Soft Start to 2018
(As of 4/30/18)

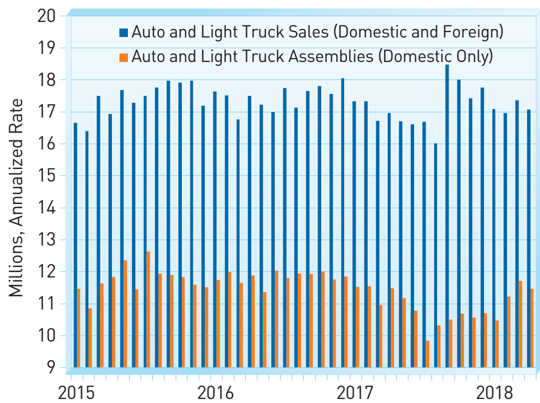


Source: Bureau of Labor Statistics

Chart 13

Vehicle Production Has Picked Up in 2018

(As of 4/30/18)

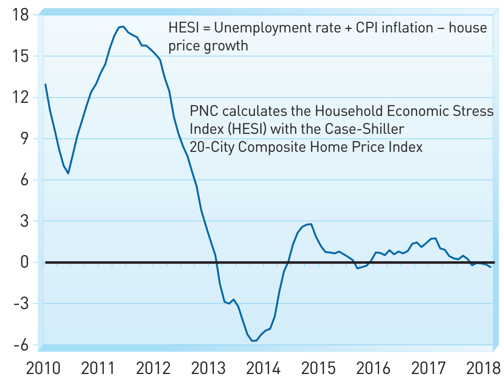


Source: Bureau of Economic Analysis

Chart 14

Household Economic Stress Receding Some This Year

(As of 2/28/18)



Source: Bureau of Labor Statistics, Federal Housing Finance Agency, PNC, Standard & Poor's